

## Message Text

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C O R R E C T E D C O P Y ( P A R A 1 )

E.O. 11652: N/A  
TAGS: EFIN, BR  
SUBJECT: BRAZILIAN ECONOMIC AND FINANCIAL INDICATORS: 1ST  
QTR 1978

REF: (A) BRASILIA 1228, (B) BRASILIA 1666, (C) BRASILIA 2340  
(D) BRASILIA 2137, (E) BRASILIA 3058, (F) BRASILIA 3347  
(G) BRASILIA 3447

1. SUMMARY - VIEWED AGAINST THE TURN AROUND IN INFLATION  
AND IMPROVEMENT IN THE TRADE BALANCE IN 1977, BRAZIL'S  
PERFORMANCE IN THE FIRST QUARTER OF 1978 WAS SOMEWHAT  
DISAPPOINT. EVEN ALLOWING FOR SEASONAL ACCELERATION IN  
PRICE INCREASES AND IMPORTS, THE \$346 MILLION CUMULATIVE  
TRADE DEFICIT AND NEARLY 10 PERCENT INFLATION IN THE FIRST  
QUARTER WERE NOT EXPECTED BY THE GOB. THE PRICE MOVEMENT HOWEVER,  
WAS NOT SURPRISING, GIVEN MONETARY EXPANSION IN THE LAST HALF  
OF 1977. THE LACK OF GROWTH IN EXPORTS WAS MAINLY ATTRIBUTABLE  
TO LOW VOLUME OF COFFEE EXPORTS WHICH COULD BE SOMEWHAT  
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OFFSET BY MORE EVEN DISTRIBUTION OF COFFEE EXPORTS OVER  
1978 COMPARED TO 1977. HOWEVER, LOWER WORLD COFFEE  
PRICES AND DROUGHT DAMAGE TO NON-COFFEE CROPS ALREADY  
BEGAN IN THE FIRST QUARTER TO ADVERSELY AFFECT THE VALUE  
OF AGRICULTURAL OUTPUT, COMMODITY EXPORT EARNINGS, AND  
DOMESTIC PRICES. THESE PRESSURES WILL PROBABLY INCREASE IN  
COMING MONTHS AS THE FULL EXTENT OF THE DROUGHT IMPACT ON CROPS

IS KNOWN. ON THE OTHER HAND, INDUSTRIAL ACTIVITY INCREASED IN THE FIRST QUARTER OF 1978 AND MANUFACTURED EXPORTS CONTINUED TO EXPERIENCE RAPID GROWTH. GOB POLICIES DURING THE PERIOD INCLUDED: MONETARY MEASURES TO RESTRAIN EXCESSIVE MONTEY SUPPLY EXPANSION; WAGE-PRICE POLICIES STILL ESSENTIALLY WEIGHTED AGAINST AGGRAVATING INFLATION BUT WITH SOMEWHAT MORE ATTENTION TO MAINTENANCE OF REAL WAGES; CONTINUATION OF MINIDEVALUATIONS BASED ON DOMESTIC AND EXPORT MARKET INFLATION AND CHANGING RELATIONSHIPS BETWEEN THE U.S. DOLLAR AND OTHER CONVERTIBLE CURRENCIES; AND A HIGH LEVEL OF FOREIGN BORROWING AS BRAZIL TOOK ADVANTAGE OF INTERNATIONAL BANK LIQUIDITY AND IMPROVING LOAN TERMS. END SUMMARY.

2. ECONOMIC INDICATORS - REAL ECONOMIC ACTIVITY IN THE FIRST QUARTER OF 1978 WAS CHARACTERIZED BY A SHARP REVERSAL FROM THAT REGISTERED IN 1977. AGRICULTURE LED THE 1977 PERFORMANCE WITH NEARLY 10 PERCENT ANNUAL GROWTH BUT SERIOUS DROUGHT IN THE SOUTH AND CENTER-SOUTH HAS RESULTED IN DOWNWARD REVISIONS IN ORIGINAL 1978 CROPS ESTIMATES. CORN AND SOYBEANS APPEAR TO BE THE MOST SERIOUSLY AFFECTED BUT PRODUCTION OF RICE AND COTTON ALSO IS EXPECTED TO FALL. COFFEE HAS NOT BEEN AS SIGNIFICANTLY DAMAGED, WITH USDA ESTIMATES OF PRODUCTION REVISED DOWNWARD BY ABOUT 10 PERCENT TO 19.5 TO 21.5 MILLION BAGS. THE IBC CROP ESTIMATE OF 20.7 MILLION BAGS HAS NOT BEEN LOWERED BUT THE LACK OF RAIN MAY HAVE REDUCED THE LIMITED OFFICIAL USE

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QUALITY OF THE BEANS. IN CONTRAST TO THE DETERIORATION IN AGRICULTURAL OUTPUT, INDUSTRIAL ACTIVITY PICKED UP IN THE FIRST QUARTER OF 1978 IN PART IN RESPONSE TO EXTERNAL DEMAND. PRODUCTION IN JAN-FEB 1978 COMPARED TO THE SAME TWO MONTHS OF 1977 WAS UP IN REAL TERMS 20 PERCENT IN TEXTILES, 14 PERCENT CHEMICALS, AND 14 PERCENT PHARMACEUTICALS. THE RISE IN STEEL PRODUCTION WAS A SATISFACTORY 10 PERCENT, CONSIDERING THAT STEEL OUTPUT EXPANSION LED OVERALL INDUSTRIAL GROWTH THROUGHOUT 1977 (IN COMPARISON, MOST OTHER INDUSTRIAL ACTIVITY SLOWED MARKETLY BEGINNING IN EARLY 1977). INDUSTRIAL CONSUMPTION OF ELECTRICITY IN THE RIO-SAO PAULO AREAS WAS 12 PERCENT HIGHER IN JAN-FEB 1978 THAN IN THE SAME TWO MONTHS OF 1977. THE VALUE OF EXPORTS OF TRANSPORTATION EQUIPMENT INCREASED BY 65 PERCENT OVER 1977 TO \$155 MILLION IN THE FIRST

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QUARTER. THE IMPORTANCE OF EXPORT DEMAND IN THE ACCELERATED INDUSTRIAL ACTIVITY WAS IMPRESSIVELY DEMONSTRATED BY AN ESTIMATED 74 PERCENT INCREASE IN THE VOLUME OF MANUFACTURED EXPORTS (EXCLUDING SEMI-MANUFACTURED PRODUCTS). CONSUMPTION OF PETROLEUM DERIVATIVES CONTINUED TO RISE AT A RELATIVELY MODEST RATE OF 4.5 PERCENT OVER 1977 AND FOR THE FIRST TIME IN MORE THAN A YEAR DOMESTIC PETROLEUM PRODUCTION INCREASED (0.3 PERCENT HIGHER IN JAN-MAR 1978 COMPARED TO THE SAME MONTHS OF 1977). THE EMPLOYMENT SITUATION REMAINED MIXED. JOB OFFERS IN THE GREATER SAO PAULO AREA WERE ABOUT 2 PERCENT BELOW LAST YEAR'S LEVEL, YET ACTUAL EMPLOYMENT AS MEASURED BY THE SAO PAULO INDUSTRIES FEDERATION INDEX REACHED AN ALL-TIME HIGH IN MARCH.

3. INFLATION - THE MONTHLY INCREASE IN DOMESTIC PRICES (AS MEASURED BY THE GENERAL PRICE INDEX FOR INTERNAL SUPPLY) REMAINED ABOVE 3 PERCENT IN MARCH FOR THE SECOND CONSECUTIVE MONTH. THE CUMULATIVE INCREASE OF 9.6 PERCENT IN JAN-MAR THEREFORE EXCEEDED THE 7.6 PERCENT RISE IN PRICES DURING THE FOURTH  
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QUARTER OF 1977. HOWEVER, HISTORICALLY THE RATE OF INFLATION IS GREATER IN THE EARLY MONTHS OF THE YEAR (REF A). THE PERFORMANCE IN THE FIRST QUARTER OF 1978 WAS BETTER THAN IN THE SAME PERIOD OF 1977 (11.5 PERCENT) AND THE ANNUAL RATE CONTINUED TO DECLINE TO 36.5 PERCENT AT THE END OF MARCH. THE

INCREASE IN CALENDAR 1977 WAS 38.8 PERCENT AND IN THE 12 MONTHS ENDING MARCH 1977 46.4 PERCENT. ACCORDING TO THE RIO COST-OF-LIVING DATE, ADMINISTERED PRICES FOR PUBLIC SERVICES INCREASED MOST SHARPLY, BY NEARLY 16 PERCENT, WHILE THE 9.6 PERCENT INCREASE IN RETAIL FOOD PRICES WAS CONSIDERABLY LESS THAN IN 1977. WHOLESAL PRICES FOR AGRICULTURAL PRICES, HOWEVER, INCREASED BY 13.7 PERCENT IN THE FIRST QUARTER, OR SOMEWHAT MILDERTHAN IN OE SAME APERIOD OF 1977. THIS PERFORMANCE PROBABLY REFLECTED THE EARLY EFFECTDY THE REDUCED OOUTPUT DUE TO

DROUGHT AND INDICATED THE INCREASED UPWARD PRESSURE ON THE COST-OF-LIVING THAT MUST BE EXPECTED LATER IN THE YEAR. PERCENTAGE CHANGES DURING:

	JAN-MARCH 77	APR - MARCH 78	76/77	77/78
GENERAL PRICE INDEX (INTERNAL SUPPLY)	11.5	9.6	46.4	36.5
WHOLESALE PRICE INDEX	10.5	10.4	45.2	35.3
AGRICULTURAL PRODUCTS	(12.9)	(13.7)	(50.8)	(38.5)
NON-AGRICULTURAL	(7.3)	(7.3)	(38.8)	(28.4)
RIO COST-OF-LIVING	13.0	8.7	44.7	37.7
FOOD	(16.5)	(9.6)	(49.7)	35.3
CLOTHING	(6.9)	(3.6)	(43.0)	(25.5)
HOUSING	(9.3)	(6.7)	(49.1)	(39.1)
PUBLIC SERVICES	(8.5)	(15.9)	(27.6)	(48.1)

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THE GOB'S ABILITY TO CONTROL THE EFFECT OF FOOD PRICES ON THE OVERALL INDICES WILL DEPEND IN LARGE PART ON THE EFFICIENCY WITH WHICH CERTAIN COMMODITIES (MAINLY CORN AND MEAL) CAN BE IMPORTED AND DISTRIBUTED IN THE INTERNAL MARKET. ALTHOUGH PRELIMINARY INDICATIONS SUGGEST THAT INFLATION CONTINUED IN EXCESS OF 3 PERCENT IN APRIL, ACHIEVEMENT OF LOWER INFLATION IN 1978 COMPARED TO 1977 WILL BE DIFFICULT.

MA  
SUBSTANTIAL AND EXPEDPTIOUS IMPORTS UINCLUDING PERHAPS SUBSIDIZATION) OF CERTAIN AGRICULTURAL PRODUCTS WOULD BE NECESSARY TO REDUCE THE RATE OF INCREASE IN PRICES TO A MONTHLY AVERAGE OF LESS THAN 2.0 PERCENT THAT WOULD BE REQUIRED TO KEEP INFLATION FOR THE YEAR IN THE 30-35 PERCENT RANGE (REF E).

4. MONETARY TRENDS - IN SPITE OF SUCCESSFUL CONTROL OVER BANK OF BRAZIL LENDING AND A TREASURY CASH BUDGET SURPLUS OF CR 9 BILLION FROM JAN THRU MAR, MONETARY CONTRACTION IN THE FIRST QUARTER 1978 FELL SHORT OF THE PERFORMANCE IN 1977 AND ALSO MISSED THE TARGETS OF THE MONETARY BUDGET. THE MONEY SUPPLY (M1) AT

THE END OF MARCH WAS CR 320.6 BILLION, WHICH REPRESENTED A DECLINE OF 1.4 PERCENT IN THE FIRST QUARTER AND AN INCREASE OF 41.8 PERCENT IN THE PRECEDING 12 MONTHS. THE CORRESPONDING FIGURES FOR 1977 WERE 4.4 PERCENT AND 36.2 PERCENT. THE MONETARY BUDGET TARGETS FOR MARCH 1978 WERE MINUS 3.1 PERCENT IN JAN - MAR AND CUMULATIVE GROWTH OF 39.4 PERCENT IN APR 1977 - MAR 1978. THE PRINCIPAL ELEMENTS IN THE DEVIATION FROM THE PROJECTED

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STRONG SEASONAL CONTRACTION WERE A 15 PERCENT INCREASE IN DEPOSITS IN THE BANK OF BRAZIL (COMPARED TO PROJECTED 3.8 PERCENT AND A DROP IN COMMERCIAL BANK DEPOSITS OF ONLY 3.2 PERCENT (PROJECTED DECLINE OF 3.5 PERCENT). THE HIGHER LEVEL OF DEPOSITS WAS LARGELY ATTRIBUTABLE TO THE GENERAL OF

CRUZEIROS BY THE CONVERSION OF FOREIGN LOANS. THIS SOURCE OF MONETARY EXPANSION CONSISTED OF 1) THE PREDICTABLE INFLOW OF APPROXIMATELY \$1.7 BILLION EQUIVALENT THAT HAD BEEN TEMPORARILY STERILIZED IN NOV-DEC 1977 AND 2) THE PROCEEDS OF NEW FOREIGN LOANS, WHICH EXCEEDED PROJECTIONS BY NEARLY \$1 BILLION IN JAN-MAR 1978 (SEE ALSO PARA 8). DOMESTIC BANK LENDING IS LISTHE PRIVATE SECTOR INCREASED 5 LB PERCENT FROM DECEMBER 1977 TO MARCH 1978, COPARED TO EXPECTATIONS OF 4.7

PERCENT. OUTSTANDING BANK OF BRAZIL LOANS INCREASED BY 4.1 PERCENT (LESS THAN THE MONETARY BUDGET PROJECTION OF 4.9 PERCENT) TO CR \$331.5 BILLION. ON THE OTHER HAND, COMMERCIAL BANK LOANS TO THE PRIVATE SECTOR ROSE BY 8.5 PERCENT (COMPARED LIMITED OFFICIAL USE

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TO A PROJECTION OF 3.8 PERCENT) AND REACHED CR\$408.8 BILLION AT THE END OF MARCH. THE SHARP INCREASE IN COMMERCIAL BANK LENDING, IN SPITE OF THE ABOVE-MENTIONED DECLINE IN COMMERCIAL BANK SIGHT-DEPOSITS, WAS BASED ON UTILIZATION OF FOREIGN LOANS (RESOLUTION 63) AND A LARGER THAN USUAL INCREASE IN TERM DEPOSITS (32.2 PERCENT IN JAN-MAR 1978 COMPARED TO 21.1 PERCENT IN THE FIRST QUARTER OF 1977.) 5. MONETARY POLICY - THE MONETARY AUTHRITIES CLAIM BE BE SATISFIED WITH OVERALL PERFORMANCE THUS FAR IN 1978. HOWEVER, FINANCE MINISTER SIMONSEN ALREADY HAS ACKNOWLEDGE D THAT LESS-THAN-PROJECTED CONTRACTION IN THE MONEY SUPPLY IN JAN-MAR IMPLIES THAT THE PROVISIONAL MONETAR BUDGET GROWTH TARGET OF 25 PERCENT FOR CY 1978 PROBABLY WILL BE EXCEEDED. THE MAIN UNEXPECTED CONTRIBUTOR TO THE MONEY SUPPLY HAS BEEN THE INFLOW OF FOREIGN EXCHANGE. RISING DOMESTIC INTEREST RATES (TO 48-52 PERCENT) AND NARROWING INTEREST SPREADS ON FOREIGN LOANS HAVE RESTORED THE ATTRACTIVENESS OF EXTERNAL RESOURCES FOR THE LOCAL BANKING SYSTEM. REDUCED COSTS ALSO HAVE ENCOURAGED HEAVY BORROWING ABROAD BY MULTINATIONALS AND THE GOB AND STATE-OWNED ENTERPRISES. THE GOB HAS WELCOMES THE INCREASINGLY READY ACCESS TO FOREIGN FINANCING BUT THE MONETARY IMPACT HAS PROMPTED PRIVATE SECTOR RUMORS THAT THE AUTHORITIES MAY ONCE AGAIN RESORT TO TEMPORARY STERILIZATION OF EXTERNAL LOAN INFLOX NEAR THE END OF THE YEAR. A SECOND POSSIBLE MONETARY MEASURE WOULD BE CREATION OF A COMPULSORY RESERVE REQUIREMENT FOR TERM DEPOSITS BUT WE BELIEVE THIS STEP IS SOMEWHAT LESS LIKELY. A MAJOR FACTOR THAT WAS NOT ANTICIPATED IN THE MONETARY BUDGET WAS THE DROUGHT DAMAGE IN THE AGRICULTURAL SECTOR. IN LATE APRIL THE GOB PROVIDED LIMITED OFFICIAL USE

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A COMBINATION OF DEBT RELIEF AND EMERGENCY CREDIT FOR FARMERS. AS A COUNTERMEASURE TO OFFSET THE EXPANSIONARY IMPACT OF THE AGRICULTURAL CREDIT DECISION, THE AUTHORITIES SIULTANEOUSLY POSTPONED INDEFINITELY THE RELEASE OF THE ADDITIONAL 5 PERCENT

COMMERCIAL BANK COMPULSORY RESERVE REQUIREMENT THAT WAS IMPOSED IN NOV-DEC 1977 AND SCHEDULED FOR RETURN TO THE BANKS IN MAY AND JUNE REF G). BOTH ACTIONS HAD BEEN EXPECTED AND AROUSED ONLY MILD PROTESTS FROM BANKERS.

6. MONETARY CORRECTION AND INCOME POLICIES - THE GOB CONTINUED IN THE FIRST QUARTER OF 1978 TO USE INDEXING OF FINANCIAL INSTRUMENTS TO MAINTAIN DOWNWARD PRESSURE ON DOMESTIC INFLATION. MONETARY CORRECTION FOR THE 12 MONTHS ENDING IN MARCH WAS ABOUT 31 PERCENT, IN COMPARISON WITH THE 35 PERCENT INCREASE IN THE

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WHOLESALE PRICE INDEX. ON THE OTHER HAND, THE GOB APPEARS TO BE MOVING GRADUALLY TOWARD SOME RESTORATION OF REAL WAGES, THE CONTRAST WITH POLICY SINCE MID-1976 WHICH RESULTED IN WAGE ADJUSTMENTS LESS THAN INFLATION. ALTHOUGH THE GUIDELINE FOR ANNUAL WAGE ADJUSTMENTS WAS REDUCED FROM 40 PERCENT IN JAN 1978 TO 39 PERCENT IN FEBRUARY AND MARCH, THE LATTER EXCEEDED THE 37.7 PERCENT INCREASE IN THE RIO COST-OF-LIVING IN THE 12 MONTHS ENDING IN MARCH 1978.

ANNUAL RATE OF  
CHANGE DURING:  
1ST QTR CY 1977 1ST QTR  
1977 1978

WAGE GUIDELINE 1/	40	40	39
MONETARY CORRECTION 2/	37.0	30.1	30.7
CR/USDOL EXCHANGE RATE 3/	35.8	29.9	27.5
RIO COST-OF-LIVING 3/	44.7	43.1	37.7
WHOLESALE PRICE INDEX 3/	45.2	35.5	35.3

1/ MINIMUM ANNUAL WAGE GUIDELINE IN LAST MONTH OF PERIOD.

2/ ADJUSTMENT IN INDEXED TREASURY BONDS DURING 12  
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MONTHS ENDING IN LAST MONTH OF PERIOD.

3/ PERCENTAGE CHANGE IN 12 MONTHS PRECEDING END OF PERIOD.

FURTHER RECENT EVIDENCE OF A SHIFT IN POSSIBLE EMPHASIS  
OF GOB INCOME POLICIES INCLUDED: 1) ANNOUNCEMENT IN  
FEBRUARY OF A 38 PERCENT INCREASE IN FEDERAL GOVERNMENT  
EMPLOYEES SALARIES, WHICH WAS NEARLY EQUIVALENT TO  
THE INCREASE IN THE COST-OF-LIVING FOR THE FIRST TIME  
SINCE 1974; 2) A 41 PERCENT INCREASE IN THE MINIMUM  
WAGE ANNOUNCED AT THE END OF APRIL. THIS LATTER  
ADJUSTMENT EXCEEDED THE ANNUAL RATE OF INCREASE  
IN THE COST-OF-LIVING BY ABOUT 3 PERCENTAGE POINTS.  
IN MAY 1977 THE ADJUSTMENT IN THE MINIMUM WAGE WAS  
44.1 PERCENT, OR SLIGHTLY LESS THAN INFLATION.  
IN ORDER TO REDUCE THE NUMBER OF GEOGRAPHIC AREAS WITH  
DIFFERENT MINIMUM WAGES FROM FIVE TO FOUR, THE GOB  
INCREASED THE MINIMUM WAGE IN THE INTERIOR OF  
PARANA, SANTA CATARINA, AND ESPIRITO SANTO BY 53  
PERCENT TO THE SAME LEVEL AS IN RIO GRADE DO SUL.  
SEVERAL GOB MINISTERS MET WITH LABOR LEADERS FOR THE  
FIRST TIME IN EARLY 1978 AND REPORTS CIRCULATED  
ABOUT PROPOSALS TO LIBERALIZE POLICIES REGARDING  
ORGANIZED LABOR AND WAGE NEGOTIATIONS. THESE STEPS  
MAY REFLECT GENUINE INCLINATIONS TOWARD POLITICAL  
OPENING AS WELL AS ELECTION YEAR POLITICS BUT THEY  
ARE NOT EXPECTED TO PRODUCE DRAMATIC CHANGES IN  
POLICY OR HAVE SIGNIFICANT ECONOMIC IMPACT IN THE  
INTERMEDIATE TERM. FINANCE MINISTER SIMONSEN  
CONTINUES TO DIRECT THE ACTIONS OF THE INTER-  
MINISTERIAL PRICE COUNCIL WITH THE AIM OF MINIMIZING  
THE ADVERSE IMPACT OF CHANGES IN CONTROLLED PRICES  
BY SPACING OUT THE INCREASES OVER THE YEAR. EXAMPLES  
OF IMPORTANT ADMINISTERED PRICE INCREASES IN  
THE FIRST QUARTER OF 1978 WERE: MEAT, 37-40 PERCENT  
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IN LATE JANUARY; IN FEBRUARY, SUGAR AND CITY BUSES,  
10 PERCENT, AND GASOLINE, 8 PERCENT (LAST PREVIOUS



CHANGES WERE IN S05-OCT 1977); CARS IN MARCH BY  
8 PERCENT WITH A CEILING OF 28 PERCENT ON AN ANNUAL  
BASIS.

7. FOREIGN TRADE AND EXCHANGE RATE - ACCORDING TO  
PRELIMINARY DATA, BRAZIL RECORDED A DOLS 2 MILLION SURPLUS  
IN ITS TRADE ACCOUNT IN MARCH AND A CUMULATIVE TRADE  
DEFICIT OF DOLS 346 MILLION IN THE FIRST QUARTER OF  
1978 (REF B AND C). THE CUMULATIVE DEFICIT WAS DOLS 157  
MILLION LARGER THAN IN THE SAME PERIOD OF 1977 AND  
RESULTED FROM A 6.7 PERCENT INCREASE IN IMPORTS AND  
ESSENTIALLY NO CHANGE IN EXPORTS. THE LACK OF GROWTH  
IN OVERALL EXPORTS WAS WHOLLY ATTRIBUTABLE TO MUCH  
LOWER LEVEL OF COFFEE EARNINGS RELATED TO BOTH LOWER WORLD  
PRICES AND AN UNUSUALLY LOW VOLUME OF EXPORTS. COFFEE EARNINGS IN

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THE FIRST QUARTER OF 1977 WERE UNUSUALLY HIGH (E.G.,  
1,022 MILLION OR 265 PERCENT ABOVE EARNINGS IN  
JAN-MAR 1976). IN CONTRAST, COFFEE EXPORTS IN  
JAN-MAR 1978 AMOUNTED TO \$438. MILLION, OF WHICH  
APPROXIMATELY ONE-HALF OCCURRED IN THE MONTH OF MARCH.  
THE DECLINE IN COFFEE EARNINGS WAS ALMOST ENTIRELY  
OFFSET BY A 35 PERCENT INCREASE IN EARNINGS FROM NON-COFFEE  
EXPORTS. PRELIMINARY REPORTS SUGGEST THAT EXPORTS OF  
MANUFACTURED PRODUCTS WERE UP 50-45 PERCENT OVER  
THE SAME PERIOD OF 1977 OWING MAINLY TO THE 74 PERCENT

INCREASE IN VOLUME EXPORTED. GROWTH OF NON-COFFEE AGRICULTURAL EXPORTS WAS CONSIDERABLY BELOW THAT PACE, HOWEVER, AND EARNINGS ARE EXPECTED TO REGISTER AN ABSOLUTE DROP OF PERHAPS \$800 MILLION BY THE END OF THE YEAR DUE TO THE EFFECTS OF DROUGHT ON EXPORTABLE SUPPLIES (REF E). COFFEE EXPORTS WILL BE MORE EVENLY DISTRIBUTED OVER THE YEAR THAN IN 1977 BUT EARNINGS MAY BE AS MUCH AS \$600 MILLION LESS THAN IN 1977 DUE TO LOWER WORLD PRICES (REF E). GOB OFFICIALS CLEARLY RECOGNIZE THE LIKELIHOOD OF A SUBSTANTIAL SHORTFALL ON AGRICULTURAL EXPORTS IN 1978  
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BUT HOPE THAT CONTINUATION OF THE FIRST QUARTER'S RATE OF GROWTH IN MANUFACTURED EXPORTS WILL COMPENSATE ADEQUATELY TO PERMIT MAINTENANCE OF A ROUGH BALANCE OR SMALL SURPLUS IN THE TRADE ACCOUNT. IN PURSUIT OF THAT OBJECTIVE BRAZIL CONTINUES TO DEPRECIATE THE CRUZEIRO IN RELATION TO FOREIGN CURRENCIES BY SPECIFIC MINI-DEVALUATIONS OF THE CR/\$US RATE. THE FIFTH SUCH RATE CHANGE IN 1978 BROUGHT CUMULATIVE DEPRECIATION IN CY 1978 VIS A VIS THE DOLLAR TO 7.6 PERCENT AS OF APRIL 26 (REF F). DEPRECIATION OF THE CRUZEIRO DURING THE SAME PERIOD WAS 14.0 PERCENT RELATIVE TO YEN AND 8.4 PERCENT AGAINST DM. (SEE PARA 6 FOR COMPRISON WITH OTHER TRENDS.)

8. FOREIGN BORROWING AND RESERVES - READY AVAILABILITY OF FOREIGN FUNDS HAS FACILIATED BRAZILIAN EXTERNAL BORROWING IN THE FIRST FOUR MONTHS OF 1978. DATA RELEASED BY THE MINISTRY OF FINANCE INDICATES THAT 19 LOANS TOTALLING NEARLY \$2 BILLION WERE SIGNED IN JAN-APR WITH GOB GUARANTY. SEVERAL LOANS WERE FROM THE WORLD BANK AND IDB AND WILL BE DISBURSED OVER THE NEXT 12-24 MONTHS. MOST OF THE FINANCING, HOWEVER, WAS FROM PRIVATE FOREIGN BANKS AND THE FUNDS WERE DRAWN DOWN IMMEDIATELY. THE RESULTING CAPITAL INFLOW WAS MORE THAN ANTICIPATED AND WAS SUFFICIENT TO FINANCE THE TRADE DEFICIT, THE DEFICIT ON SERVICES, AND DEBT AMORTIZATION IN THE FIRST QUARTER. GROSS FOREIGN EXCHANGE RESERVES DECLINED IN SEASONAL FASHION IN JAN-FEB BUT THEN REBOUNDED TO THE END-1977 LEVEL OF \$7.2 BILLION BY MID-APRIL. RESERVES ARE EQUIVALENT TO APPROXIMATELY 7 MONTHS OF MERCHANDISE IMPORTS AT THE RATE REGISTERED IN JAN-MAR 1978 AND ARE A FACTOR IN THE CONFIDENCE EXPRESSED BY FOREIGN BANKERS WITH REGARD TO BRAZIL'S CREDITWORTHINESS. ALSO MANY BANKERS HAVE INDICATED TO EMBASSY  
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OFFICERS THAT THEY ARE NOT SERIOUSLY CONCERNED ABOUT THE UNPROMISING TRADE PROSPECTS IN 1978 BECAUSE THEY SEE THEM AS A TEMPORARY SETBACK DUE TO WORLD PRICES AND ADVERSE WEATHER AND NOT CAUSED BY FAULTY GOB POLICIES. EVEN MORE IMPORTANT THAN THE BANKERS PERCEPTIONS OF BRAZIL'S EXTERNAL TRADE PROBLEMS IN 1978 IS THE CURRENTLY HIGH LEVEL OF FOREIGN BANK LIQUIDITY. INCREASED EFFORTS TO LEND TO BRAZIL HAVE RESULTED IN A STEADY AND SUBSTANTIAL DECLINE IN INTEREST RATE SPREADS ON LOANS TO BRAZIL IN THE LAST 6 MONTHS. MOST RECENT EXAMPLES OF THE TREND INCLUDE: A 5 YEAR LOAN OF \$25 MILLION TO THE BRAZILIAN MINT AT 1 PERCENT OVER LIBOR; A \$250 MILLION LOAN FOR THE BRAZILIAN MERCHANT MARINE (SUNAMAM) AT 1.5 PERCENT OVER LIBOR FOR 10 YEARS (SUNAMAM IS NOT AMONG THE BLUE-CHIP STATE ENTERPRISES AND IN LATE 1977 BORROWED \$160 MILLION IN PORTIONS AT 1.875 PERCENT SPREAD FOR 5 YEARS AND 2.125 PERCENT SPREAD FOR 7 YEARS.) THE NARROWING OF INTEREST SPREADS AND LENGTHENING OF MATURITIES SUGGESTS THAT BRAZIL SHOULD HAVE NO DIFFICULTY IN RAISING THE ESTIMATED \$5.5 - 6.0 BILLION IN GROSS NEW FINANCIAL LOANS WHICH, AFTER DIRECT INVESTMENT, BOND ISSUES, AND IMPORT FINANCING, WILL BE REQUIRED TO COVER THE CURRENT ACCOUNT DEFICIT AND AMORTIZATION OF DEBT IN 1978 (REF D). INDEED, THE GOB AUTHORITIES MAY BE INCLINED TO TAKE ADVANTAGE OF PREVAILING FAVORABLE MARKET CONDITIONS TO INCREASE GROSS RESERVES. THIS INCLINATION, HOWEVER, WILL BE TEMPERED BY THE DESIRE NOT TO AGGRAVATE THE MONETARY SITUATION.

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## Message Attributes

**Automatic Decaptioning:** X  
**Capture Date:** 01 jan 1994  
**Channel Indicators:** n/a  
**Current Classification:** UNCLASSIFIED  
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**Disposition Comment:** 25 YEAR REVIEW  
**Disposition Date:** 20 Mar 2014  
**Disposition Event:**  
**Disposition History:** n/a  
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**Review Markings:**  
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